

Capital Movements in the United States

Balance of Payments

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POLITICAL developments in Europe during the past 6 months have dramatically directed attention to the extraordinarily heavy imports of gold to this country and to the large volume of capital movements which are more or less directly related to the gold shipments from abroad. This large and persistent movement of gold from Europe to the United States during recent months is an acceleration of a movement which has dominated the balance of international payments of the United States since the beginning of 1934. The flight of capital from Europe induced last fall by the crisis which was ostensibly resolved at Munich was only temporarily halted by the dissipation of immediate war fears. During the first 4 months of 1939 the gold inflow exceeded \$1,300,000,000.

Table 1.—Relation of Net Capital Inflow to Other Important Transactions in Balance of Payments, 1934-38
(In millions of dollars)

Year	I Reported net capital inflow	II Merchandise export balance	III Net receipts on merchandise and service account	IV Net gold imports ¹	V Net silver imports	VI Net gold and silver imports	VII Residual item ²
1934.....	800	478	321	1,217	80	1,803	482
1935.....	1,558	230	183	1,739	390	2,075	364
1936.....	1,187	33	133	1,830	174	1,904	170
1937.....	881	265	15	1,388	83	1,469	873
1938.....	288	1,133	905	1,810	224	1,864	402
Total..	4,895	2,145	1,471	7,912	962	7,915	2,945

¹ Including untracking operations.

² In addition to errors and omissions this item includes certain unreported capital and other transactions.

³ Net payments.

Note.—The aggregate amounts of columns I, III, and VII equal the amount reported in column VI.

As indicated in table 1, net gold acquisitions from foreign sources have exceeded \$1,000,000,000 during each of the past 5 years. The record net inflow of \$1,739,000,000 in 1935 was materially influenced by the intermittent political and financial crises of that year in the "gold bloc" countries, notably in France, and by the critical political developments in October which resulted from Italy's invasion of Ethiopia. The net gold inflow of \$7,912,000,000 during the 5 years, 1934-38, together with additions from domestic production, lifted the value of the monetary gold stocks from \$6,829,000,000 immediately after dollar devaluation on January 31, 1934, to \$14,512,000,000 on December 31, 1938, and to \$15,795,000,000 on May 1, 1939.

Under normal conditions, when international balances are settled through the functioning of the international gold standard, the volume of gold movements tends to be determined primarily by the volume of net receipts or payments required to bring the merchandise and serv-

ice account into balance. The exceptional character of international capital movements in the United States balance of international payments during the past 5 years is indicated by the close correlation over much of the period between the net gold inflow and the net movement of capital. (See fig. 4.) During the last quarter of 1937 and during 1938, when the excess of merchandise exports over imports became abnormally large and created an additional demand for dollars in the exchange markets, the net capital imports did deviate substantially from net gold movements. The relationship between gold (and silver) imports, on the one hand, and capital movements, on the other, is also shown in table 1. With the exception of 1934 and 1938, the net receipts due this country on account of merchandise and service transactions were relatively small. The net reported inflow of capital amounted to \$1,538,000,000 in 1935 when estimated net receipts on merchandise and service account were only \$183,000,000, while in the following year the net inward capital movement, as reported, amounted to \$1,187,000,000 in the face of actual net payments made by this country on its commodity and service transactions.

Although acquisitions by the United States of foreign gold and silver have continued virtually unbroken since dollar devaluation, the contributing factors have not always been the same. At certain times the inflow was induced primarily by a flight of capital from foreign centers. During 1936 and the first half of 1937, the demand for dollars and the process of making dollars available through the foreign sale of gold was materially influenced by the favorable business prospects in this country which encouraged the foreign purchase of American securities. An important factor during most of the period has been the purchase by foreign obligors or their agents of outstanding security issues for redemption or for sinking-fund purposes. In general, it may be said that inward capital movements caused by disturbed political conditions abroad tend to be reflected in an accumulation of foreign-owned dollar balances, whereas capital imports which result primarily from favorable business prospects in this country are more likely to increase the volume of foreign-held American corporate securities.

In addition to the exceptionally large merchandise export balance, another feature of the United States balance of international payments in 1938 which appears at first somewhat unusual is the comparatively small net inflow of capital. This is, however, merely a coincidence arising from the fact that the international

balance is compiled on a calendar-year basis. During 1937, a steady net capital inflow during the first three quarters had been sharply reversed during the final quarter. (See fig. 4.) This outward movement continued during the first half of 1938 only to be sharply shifted again to a net inflow during the second half. During the first 2 months of 1938, the repatriation of foreign funds from the United States and the excess of merchandise exports were virtually in balance. Gold

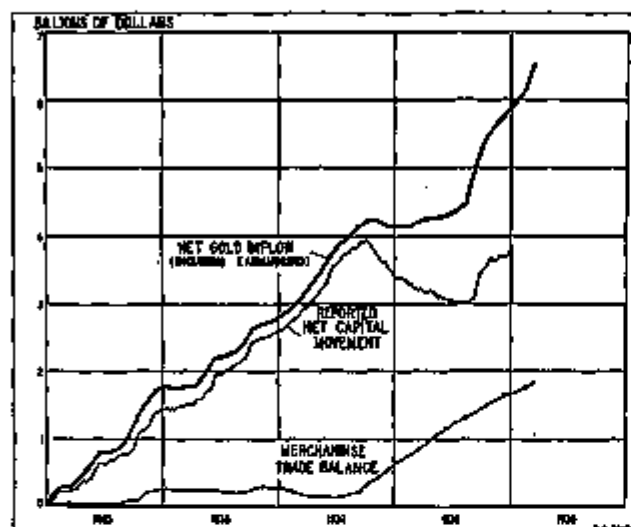


Figure 4.—Cumulative Net Movements of Gold and of Capital Between the United States and Foreign Countries, and Cumulative Excess of Merchandise Exports Over Imports Since January 1, 1935 (Net Gold Inflow, Board of Governors of the Federal Reserve System; Net Capital Movement, U. S. Treasury Department; and Merchandise Trade Balance, U. S. Department of Commerce).

Note.—Data for "Net Capital Movement" are plotted weekly; other data are plotted monthly. Statistics subsequent to December 28, 1938, for the former item were not available in time to include them in this chart.

imports became negligible but rose again in March at the time of Germany's annexation of Austria. This trend was sharply reversed during the second half of the year, and especially in the last 5 months, during which funds moved to the United States in unprecedented amounts. With the development of the crisis in Czecho-Slovakia, foreign short-term funds entered in extraordinary volume, while an improvement in security prices and business prospects led to renewed net buying by foreigners of American securities. The large aggregate inward movement of short-term and long-term capital funds, together with the substantial merchandise export balance, accounted for unusually heavy imports of gold which contributed to the year's net gold inflow of \$1,840,000,000. The net capital inflow of \$430,000,000 was, in effect, part of the much larger gross movement which occurred during the last 5 months of the year.

A striking feature of the statement on the balance of international payments of the United States, which the Department of Commerce has recently released, is the rise in the export trade balance from \$265,000,000 in 1937 to \$1,133,000,000 in 1938—the largest merchandise export balance in 17 years. This change was

directly responsible for the reappearance of a large excess of receipts from foreigners on trade and service account, and was consequently a prime factor in the continued heavy inflow of gold from abroad.

Smaller net payments to foreigners for services, which fell to approximately \$170,000,000 from \$250,000,000 in 1937, further augmented the excess of receipts from foreigners for goods and services in 1938. Payments to foreigners for freight and shipping services dropped from the high figure of 1937 largely as a consequence of the decline in merchandise imports. Oversea travel fell off more in proportion than Canadian travel, but per capita expenditures in overseas countries were higher in 1938 than in 1937. Travel to the United States from other countries was well maintained in 1938, and outlays in this country by foreign travelers were practically unchanged from the preceding year.

Receipts of interest from foreign dollar bonds in 1938 fell below those of 1937 because of smaller principal amounts outstanding after the effect of sinking-fund and redemption operations was realized. Income from direct investments, largely dividends, decreased sharply because of the drop in raw material prices and a lower level of business activity in various countries of the world in which this class of American investment is substantial. Payments to foreigners, predominantly dividends on holdings of common stock of United States corporations, fell by more than 25 percent. Estimated net receipts by the United States on interest and dividend account declined from \$330,000,000 in 1937 to \$275,000,000 in 1938.

Personal remittances to foreign countries by alien and other residents of the United States were appreciably smaller in 1938 than in 1937. Larger contributions to foreign countries in 1938 by charitable, religious, and other institutions in the United States, on the other hand, indicated the response of American contributors to distress in Europe and Asia. All trade and service items resulted in net receipts by the United States from foreigners estimated at \$965,000,000, a balance larger than that in any year since 1921. Corresponding transactions in 1937 produced net receipts of only \$15,000,000, and in 1936 there were net payments amounting to approximately \$150,000,000.

The relationship between gold movements, capital movements, and other classes of international transactions during 1938, as well as during other recent years, is reflected in table 1. As indicated in the footnote to this table, the aggregate of columns I, III, and VII equals the amount shown under column VI. This is merely a convenient way of stating the relationship of the respective items since capital movements as well as trade and service transactions (except in 1936) have resulted in net dollar receipts, whereas the residual item is also a "net receipt" item covering possible errors and transactions not identified or separately recorded.

Dollar devaluation on January 31, 1934, was immediately followed by a return flow of United States funds,

which had been expatriated during 1933 while the dollar was being steadily depreciated in the foreign exchange markets through gold purchases abroad at varying prices by the Reconstruction Finance Corporation. The return of the dollar to a new fixed gold value at a materially reduced level also attracted foreign funds, a substantial part of which apparently found its way into our security markets.

Except for a period of about 5 weeks immediately following devaluation, the inflow of capital during 1934 did not assume unusually large proportions. During the following year when pressure on the franc and other gold-bloc currencies became increasingly severe, the inward movement became highly accelerated. Because of conditions abroad which generated the expatriation of foreign funds to the United States, especially the temporarily disturbed conditions in the financial markets at the time of the Italo-Ethiopian

and 1937, the net balance on account of merchandise and service transactions, whether credit or debit, was not sufficiently large to constitute on a strictly statistical basis an important factor in the volume of gold movements. Although the credit balance in 1934 was relatively large, the exceptional nature of this balance in 1938 is clearly demonstrated by the fact that the recorded "export" surplus on merchandise and service account of \$965,000,000 represented about 65 percent of the cumulative net receipts for the 5-year period.

According to the Treasury Department, the net inflow of foreign funds for the purchase of American securities during the 4 years 1935 to 1938, inclusive, amounted to \$1,210,874,000. This indicates the rate at which foreign "long-term" investments in the United States have risen since the end of 1934 when a special study, made by the Finance Division of the Bureau of Foreign and Domestic Commerce, placed the total at \$4,357,000,000. In addition, foreign repurchases of foreign securities for sinking-fund, redemption, investment, or other purposes involved a net inflow of foreign capital funds which during the same 4-year period amounted to \$610,000,000. The more or less regular rate at which

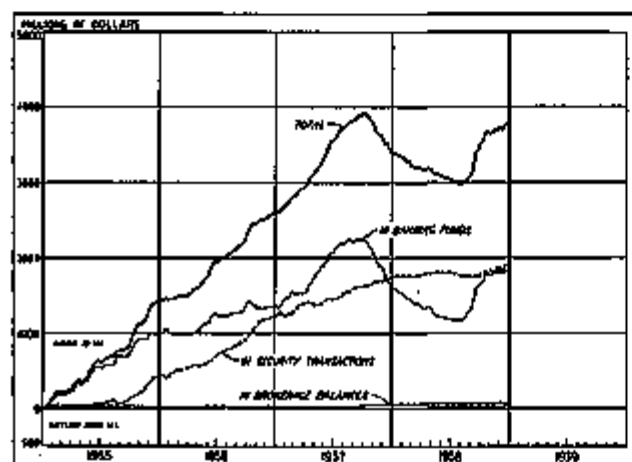


Figure 5.—Cumulative Net Capital Movement Between the United States and Foreign Countries.

dispute, the greater part of these funds was seeking safety rather than investment. During 1935 about 70 percent of the inward capital movement was reflected in an inflow of more than \$1,000,000,000 in short-term banking funds. The sustained inflow of funds into security transactions accounted for about 65 percent of the year's inward capital movement. The inflow of short-term capital during 1936 was concentrated largely in May and June and at the time of the gold-bloc currency crisis in September. The movement of foreign funds into American securities continued on a high level throughout the year and the first quarter of 1937. As business prospects became less favorable toward the middle of 1937, net foreign purchases of American securities ceased, but after a short period of irregular net liquidation excess purchases by foreigners were resumed, although at a much lower rate than in 1936.

The inflow of gold during 1938 was exceptional in the sense that it exceeded, by a considerable amount, the sum of the net capital inflow and the residual item which in many instances is certain to represent the inflow of unidentified capital funds. During 1935, 1936,

Table 2.—Reported Net Capital Inflow, 1934-38

(In millions of dollars)

Year	Long-term	Short-term	Total
1934	203	158	360
1935	482	1,070	1,552
1936	775	414	1,187
1937	522	350	871
1938	124	300	424
Total	2,066	2,313	4,379

the inflow of \$1,821,000,000 in foreign long-term capital funds into the United States occurred is shown in figure 5. The more erratic nature of the movement of short-term banking funds and the wider swings in relation to the movement of funds employed in security transactions are also clearly indicated in figure 5. The greater degree of volatility of the former is explained by the difference in the causal influences underlying the respective movements. As already indicated, "flight" funds are by their very nature sensitive to political and financial disturbances, and move capriciously back and forth seeking safety rather than investment.

The inflow of short-term banking funds, the trend of which during 1935-38 is shown in figure 5, consists of two distinct parts—the inward movement of foreign-owned banking funds and the repatriation of American banking funds from abroad. The net inflow of short-term capital since the end of 1933, which amounted to \$2,313,000,000 (see table 2), is the result of a net increase of approximately \$1,500,000,000 in total short-term foreign liabilities of American banks outstanding at the end of 1938, and a net withdrawal or liquidation of more than \$800,000,000 in short-term American-owned banking assets held abroad.